CREDIT OPINION
14 July 2021

Rate this Research

Contacts

Lori C Trevino *AVP-Analyst* lori.trevino@moodys.com	+1.415.274.1757
Gregory W. Lipitz *VP-Sr Credit Officer/Manager* gregory.lipitz@moodys.com	+1.212.553.7782
Joseph Manoleas *Analyst* joseph.manoleas@moodys.com	+1.415.274.1755
Eva Bogaty *VP-Sr Credit Officer/Manager* eva.bogaty@moodys.com	+1.415.274.1765

Honolulu (City & County of) HI

Update to credit analysis

Summary

The City and County of Honolulu, HI (Aa1 negative) has a massive tax base that has shown healthy long-term growth, supporting the strength and stability of the city and county's financial profile derived from that tax base. Although the coronavirus pandemic severely curtailed tourism activity, a driver of the economy, most of Honolulu's revenue is derived from property taxes.

Ample liquidity supports Honolulu's solid financial profile. Large private and public construction projects and a significant military presence provide a counterbalance to an economy that was significantly slowed by the coronavirus, but is now recovering as domestic and some international travel restrictions are being lifted. Also, the city has been the beneficiary of substantial federal aid.

Debt, pensions and OPEB liabilities are relatively high, but currently manageable. While the city has over the last several years adjusted its financial operations to manage rising pension and OPEB costs, fixed costs are high and will remain a pressure.

Credit strengths

» Strong economic conditions that include a healthy and growing tourism industry, extremely low unemployment levels, and an expanding tax base

» Solid history of prudent fiscal management

» Commitment to and progress toward reducing pension and OPEB liabilities

Credit challenges

» Uncertainty surrounding the timing of rail construction, final construction costs and size of future operating subsidy

» High cost of living and vulnerability to shifts in the tourism sector

» Elevated and rising fixed cost burden from pensions, debt and retiree medical costs

Rating outlook

The negative outlook primarily reflects our view that the city's rail project, which has been affected by cost increases, construction delays and technical difficulties, poses a significant contingent liability to the city. Pandemic-driven shortfalls in the portions of dedicated tax revenue that support the rail project have incrementally increased the risks.

Other factors influencing the outlook include the likelihood that while tourism is beginning to rebound, there remains some uncertainty regarding the pace and sustainability of the recovery. Also, the state made permanent the shift of some revenue away from the county, the loss of which revenue will likely contribute to a narrowing of city and county's fiscal flexibility.

Factors that could lead to an upgrade

» Greater certainty regarding rail costs, revenue streams and plans to address their impact on the city and county's finances

» Significant improvement in funding of OPEB and pension liabilities to reduce fixed costs

Factors that could lead to a downgrade

» Material growth in the city and county's contribution to the rail project

» Material decline in the city and county's financial profile

» Trend of increasing fixed costs

» Sustained economic weakness leading to declines in assessed values and property tax collections

Key indicators

Exhibit 1

Honolulu (City & County of) HI

	2016	2017	2018	2019	2020
Economy/Tax Base					
Total Full Value ($000)	$187,718,834	$199,626,577	$211,569,917	$226,641,985	$242,256,423
Population	986,999	990,060	987,638	984,821	984,821
Full Value Per Capita	$190,192	$201,631	$214,218	$230,135	$245,990
Median Family Income (% of US Median)	132.4%	131.8%	131.3%	131.0%	131.0%
Finances					
Operating Revenue ($000)	$1,444,691	$1,573,455	$1,632,658	$1,792,994	$1,938,739
Fund Balance ($000)	$315,640	$326,511	$447,548	$513,264	$584,795
Cash Balance ($000)	$395,140	$279,631	$450,959	$546,723	$656,111
Fund Balance as a % of Revenues	21.8%	20.8%	27.4%	28.6%	30.2%
Cash Balance as a % of Revenues	27.4%	17.8%	27.6%	30.5%	33.8%
Debt/Pensions					
Net Direct Debt ($000)	$2,749,028	$2,821,693	$3,294,326	$3,576,787	$3,727,098
3-Year Average of Moody's ANPL ($000)	$2,578,646	$3,383,118	$4,054,323	$4,651,088	$5,107,203
Net Direct Debt / Full Value (%)	1.5%	1.4%	1.6%	1.6%	1.5%
Net Direct Debt / Operating Revenues (x)	1.9x	1.8x	2.0x	2.0x	1.9x
Moody's - ANPL (3-yr average) to Full Value (%)	1.4%	1.7%	1.9%	2.1%	2.1%
Moody's - ANPL (3-yr average) to Revenues (x)	1.8x	2.2x	2.5x	2.6x	2.6x

Sources: Governmental data, audited financial statements and Moody's Investors Service

Profile

Coterminous with the island of Oahu, the City and County of Honolulu is the capital city of the State of Hawaii (Aa2 stable) and the economic and political center of the state. Approximately one million people live on the island, constituting nearly 70% of the state's population.

Detailed credit considerations

Economy and tax base: tourism is rebounding; AV growth expected to resume in future years

Honolulu's economy and tax base have historically been key credit strengths, and are beginning to see recovery from the economic effects of the coronavirus pandemic, which posed a significant and abrupt challenge to that trend. Tourism, a primary economic driver, was effectively halted since mid-March 2020 with the statewide implementation of a mandatory 14-day quarantine and the closure in Honolulu of all non-essential businesses. In recent months, visitor counts have nearly recovered to pre-pandemic levels, but the mix of travelers is primarily domestic, with international travelers yet to return to the island. The unemployment rate reached 20% at the height of the pandemic, but has now recovered to 6.7% of May 2021.

Given the island's strategic location in the middle of the Pacific, military activity has been an important and stabilizing factor for the local economy for decades. The island serves as headquarters to US Indo-Pacific Command with large operational footprints at Joint Base Pearl Harbor-Hickam and Marine Corps Air Station Kaneohe Bay. Aside from the tourism and military sectors, Honolulu is also anchored by a significant public sector while health care, banking and agriculture add further diversity. Notably, substantial public and private construction projects have continued through the pandemic.

The city and county's assessed value is large and has shown robust growth over the last decade, driven by large residential and commercial development activity, particularly in the urban core. Given the weakness in tourism activity over the last year, we expect commercial property values to soften in the near term, offsetting gains in residential property values. Between 2010 and 2021, assessed valuation (AV) increased by 46.5%, reaching $242.9 billion. Assessed values for 2022 fell slightly by 1.0% (to $240.1 billion) reflective of declines in commercial property values offsetting gains in residential values. Despite several large hotel and commercial properties, no single taxpayer represents more than 1.1% of AV, and the ten largest taxpayers represent just 6.5% as of 2021 AV.

Financial operation and reserves: healthy reserve and liquidity positions

The city and county's finances are a credit strength that should remain solid despite the devastating economic effects of the coronavirus pandemic. Honolulu's operating revenues are principally generated from property taxes (79.6% in 2020), followed by licenses and permits (11.6%). Because assessed values lag real market activity by 18-24 months, the city is able to project the bulk of its revenues with a high degree of accuracy. As an added credit strength, property taxes for operations (including debt repayment) are not restricted by rate or amount and are not subject to voter approval, giving the city and county considerable revenue raising flexibility. The city and county did provide some property tax relief to residents by spreading out semiannual payments over four months.

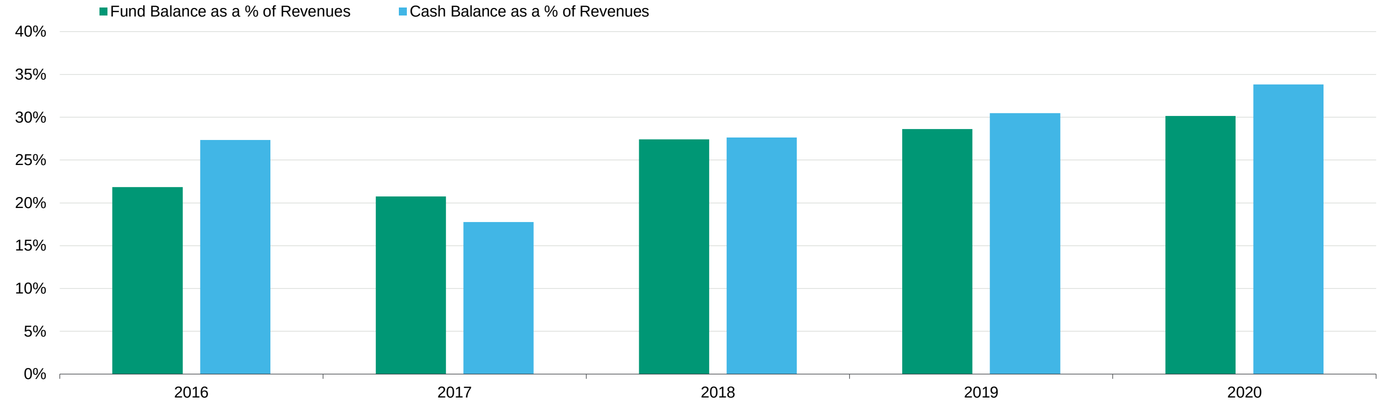
Honolulu's near-term financial health has been bolstered with federal aid to address the effects of the coronavirus. The city and county anticipates $773 million of total federal government aid, including $387 million under the CARES Act and $193 million under the American Rescue Plan which have already been received. As a result of the stability in property tax revenue and additional federal aid, Honolulu's management team is expecting fiscal 2021 to be structurally balanced and has budgeted for a modest surplus in fiscal 2022.

The city and county did not receive its very modest share of transient accommodation tax (TAT) revenue from the state in fiscal 2021. The state has enacted legislation to make this shift of the tax back to the state permanent, but the state is providing the counties with the option to levy their own TAT up to 3%. Honolulu has not determined whether to impose a TAT, but a 3% TAT would provide about $75 million annually, significantly higher than the $45.4 million that had previously been allocated to Honolulu by the state in years 2016 through 2019.

On an operating funds basis (which Moody's defines here as including the general fund, debt service fund, and Highway Fund), Honolulu ended fiscal 2020 with available reserves of $584.8 million, equal to 30.2% of operating revenues (see Exhibit #2), a level comparable to similarly rated peers of its size. This figure excludes a sizeable receivable in the form of an advance to the Honolulu Authority for Rail Transit in the General Obligation Bond Interest and Redemption Fund. Available reserve levels as a percentage of revenues are slightly above the city and county's five year average of 26.4% and reflect a strong General Fund performance and the effects of financing activities.

Exhibit 2

Honolulu's financial position is healthy for the rating level



Source: Moody's Investors Service and audited financial statements

The city and county's direct support for the construction of rail built by the Honolulu Authority for Rapid Transportation (HART) appears manageable, as it will be limited to $214 million of the project's expected $12.4 billion costs (including financing). Notably, the project has faced significant delays and cost overruns, and the current cost project reflects an increase of $3.6 billion since last year and far above the initial estimate of $5.2 billion. Originally expected to be finished in 2019, completion of the rail system is currently expected by 2031. While HART is reviewing cost estimates to find savings and expects to turn over the first segment of the system to the city's transportation department in spring 2022, both cost overruns and potential delays materially increased in the last year, which pose an additional contingent liability for the city.

Although the current size of the city and county's capital contributions are modest and manageable, significant uncertainty remains around the completion of the final portion of the rail. Additionally, the city and county are expecting to provide an annual operating subsidy of $87 million once full system operations begin in 2026 out of a total operating cost of $127 million, with operating costs additionally supported by a projected $40 million in farebox revenues. At this size, the annual operating subsidy would be a relatively manageable share of Honolulu's annual operating budget. However, the size of the subsidy will likely be determined by the ridership figures and pricing structure of the system, which remain uncertain. The city conservatively expects to subsidize most of the operating costs during interim operations.

Liquidity

Liquidity is solid. Despite a high dependence on property tax revenues, Honolulu has not engaged in short-term borrowing to manage its operating cash flow needs. At the end of fiscal 2020, the city and county held $656.1 million of cash and investments in its operating funds, or a strong 33.8% of revenue, while cash and investments citywide totaled more than $2.7 billion.

Debt and pensions: high fixed costs and retirement liabilities relative to peers

The city and county has a very large debt portfolio in absolute terms but manageable relative to its tax base and operating revenues. With the issuance of the 2021 general obligation bonds, the city and county will have $4.5 billion in general obligation debt, which equates to 1.9% of full value and 2.6 times operating revenue, although about 26% of this amount being self-supporting or reimbursable, which reduces the burden on the city and results in more managable debt. Honolulu benefits from the active role the state government plays in financing traditional municipal capital needs more typically funded at the local level throughout the rest of the country including education, health, and justice. Notably, the state constitution prohibits the state from levying a property tax.

Legal security

The bonds are secured by an unlimited property tax pledge; debt service payments represent a first charge on the city and county's general fund.

Debt structure

The city and county's governmental (non-enterprise) debt structure is conservative, with a rapidly declining debt service schedule that reaches final maturity in 2046. The city and county and HART have a memorandum of understanding that requires HART to reimburse the city and county for debt service and costs associated with the issuances of GO bonds related to rail. The city and county has issued $1.1 billion (net) in GO bonds for rail. As discussed above, GET and TAT weakness poses a modest but manageable additional credit risk for Honolulu because of this financing structure.

Debt-related derivatives

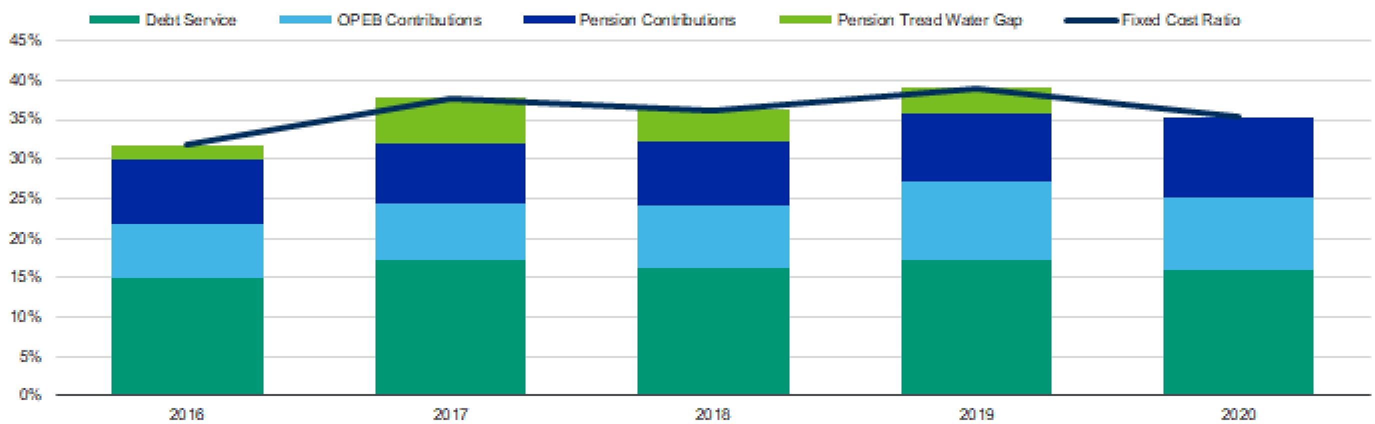
The city has no derivative instruments in its GO borrowing program.

Pensions and OPEB

Pensions and OPEB liabilities are significant credit challenges for Honolulu that are being actively addressed with increased contributions that have materially increase fixed costs recently but are expected to moderate substantially beginning in 2022. Eligible employees of the city and county are participants in the State of Hawaii's Employees' Retirement System (ERS), a multiemployer cost-sharing defined benefit pension system. The city and county has an above average defined-benefit pension burden based on Moody's approach to evaluating pension liabilities. Reported unfunded liabilities in fiscal 2020 were approximately $2.7 billion. Net of shares allocated to business enterprises based on actual contributions from those entities, the three year average Moody's adjusted net pension liability (ANPL) for the city, under our methodology for adjusting reported pension data, is $6.2 billion through 2020, equal to a somewhat high 3.2 times operating revenues and 2.6% of full value.

Exhibit 3

Honolulu's fixed costs are elevated



Source: Moody's Investors Service and audited financial statements

In recent years the state legislature has enacted higher employer contribution rates to address the system's large unfunded liability, which grew significantly in 2016 with a lowering of the discount rate to 7.0% from 7.65%. Employer contributions have increased over the last several years, up to 41% of payroll for police and fire and 24% for general employees in fiscal 2021. The increased rates are projected to eliminate the unfunded actuarial accrued liabilities by 2045.

Additionally, the city's net OPEB liability (NOL) is sizeable. As of July 1, 2020, the reported NOL was $1.90 billion. Our Moody's adjusted NOL for fiscal 2020 is $3.6 billion. Positively, Honolulu began setting aside amounts to pre-fund its OPEB liability beginning in 2008, and the 2020 payment is equal to 100% of its annual OPEB ARC. City and county managers believe the cost increases associated with both pension and OPEB are manageable within the existing budget framework, with pension and OPEB contributions increasing by approximately 7.9% in 2021, but moderating to 3% to 3.4% annual increases from 2022 through 2030.

ESG considerations

Honolulu (City & County of) HI's ESG Credit Impact Score is neutral-to-low CIS-2.

Exhibit 4
ESG Credit Impact Score

CIS-2
Neutral-to-Low

For an issuer scored CIS-2 (Neutral-to-Low), its ESG attributes are overall considered as having a neutral-to-low impact on the current rating; i.e., the overall influence of these attributes on the rating is non-material.

Source: Moody's Investors Service

ESG CIS impact score is CIS 2, reflective of neutral-to-low environmental and social risk exposures coupled with strong governance, ultimately supporting the city's ability to withstand and respond to shocks, and leading to a strong credit rating

Exhibit 5
ESG Issuer Profile Scores

ENVIRONMENTAL	SOCIAL	GOVERNANCE
E-2	**S-2**	**G-2**
Neutral-to-Low	Neutral-to-Low	Neutral-to-Low

Source: Moody's Investors Service

Environmental
The county's overall environmental issuer profile score is neutral-to-low (**E-2**) given the limited exposure of the city to carbon transition and waste and pollution. However, the city is vulnerable to some physical climate risks from exposure to sea level rise. Notably, the city has positive risk exposure to water management and natural capital, which is a key driver for the state's dominant tourism industry

Social
Exposure to social risk is neutral to low (**S-2**). The city is facing challenging demographic trends, including an aging of the work force and a flat-to-declining population, driven in part by the high cost of housing. Risks from labor & income, educational attainment and access to basic services is neutral to low. Low crime rates and widespread health insurance coverage contribute to positive healthy and safety risk exposures

Governance
A healthy institutional and governing framework for the county, including a legally unrestricted ability to raise property taxes, contributes to an overall governance profile score of **G-2**. Budget management is a key strength for the county, with a consistent history of meeting or exceeding expectations. The city has a demonstrated commitment to transparency through regular financial disclosures, though challenges around mass transit efforts have been mired in delays and significant cost overruns, which weakens our view of the city's policy credibility and effectiveness.

Rating methodology and scorecard factors

The US Local Government General Obligation Rating Methodology includes a scorecard, a tool providing a composite score of a local government's credit profile based on the weighted factors we consider most important, universal and measurable, as well as possible notching factors dependent on individual credit strengths and weaknesses. Its purpose is not to determine the final rating, but rather to provide a standard platform from which to analyze and compare local government credits.

Exhibit 6

Honolulu (City & County of) HI

Scorecard Factors and Subfactors	Measure	Score
Economy/Tax Base (30%) [1]		
Tax Base Size: Full Value (in 000s)	$240,122,162	Aaa
Full Value Per Capita	$243,823	Aaa
Median Family Income (% of US Median)	131.0%	Aa
Notching Adjustments:[2]		
Institutional Presence		Up
Economic Concentration		Down
Finances (30%)		
Fund Balance as a % of Revenues	30.2%	Aaa
5-Year Dollar Change in Fund Balance as % of Revenues	13.5%	Aa
Cash Balance as a % of Revenues	33.8%	Aaa
5-Year Dollar Change in Cash Balance as % of Revenues	13.1%	Aa
Notching Adjustments:[2]		
Outsized Contingent Liability Risk		Down
Management (20%)		
Institutional Framework	Aa	Aa
Operating History: 5-Year Average of Operating Revenues / Operating Expenditures (x)	1.01x	A
Notching Adjustments:[2]		
State Oversight or Support		Up
Debt and Pensions (20%)		
Net Direct Debt / Full Value (%)	1.9%	A
Net Direct Debt / Operating Revenues (x)	2.3x	A
3-Year Average of Moody's Adjusted Net Pension Liability / Full Value (%)	2.1%	A
3-Year Average of Moody's Adjusted Net Pension Liability / Operating Revenues (x)	2.6x	A
Notching Adjustments:[2]		
Unusual Risk Posed by Debt/Pension Structure		Down
Other		
Credit Event/Trend Not Yet Reflected in Existing Data Sets: Exposure to climate change		Down
	Scorecard-Indicated Outcome	Aa2
	Assigned Rating	Aa1

[1] Measures are based on data from the most recent year available.
[2] Notching Factors are specifically defined in the US Local Government General Obligation Debt methodology dated January 26, 2021.
[3] Standardized adjustments are outlined in the GO Methodology Scorecard Inputs Updated for 2020 publication.
Source: Governmental data, audited financial statements, Moody's Investors Service

REPORT NUMBER 1295043

CLIENT SERVICES

Americas	1-212-553-1653
Asia Pacific	852-3551-3077
Japan	81-3-5408-4100
EMEA	44-20-7772-5454

MOODY'S INVESTORS SERVICE